and that lower rates would be used to fill excess capacity. When rates were not decreased as rapidly as anticipated, the CPUC reminded the carriers of their promises in the 1993 Rate Band Guidelines Decision:

> . . . The record generally indicates that limits on the spectrum are not a constraint on carriers at the present time. Given the rapid growth in consumer demand for cellular service, that circumstance may change for at least some systems. However, for under-utilized systems we will expect rates to fall substantially and quickly following our grant of pricing flexibility. . . . Further, technology is commercially available. Digital conversion will provide three to four times the present capacity. Carriers will need to cut prices sharply to fill that capacity. If they do not, then we will do it for them based on the results of our monitoring. We will also expect the geographical scope of service availability to continue to expand, with corresponding service quality improvements for the more rural or outlying areas in each service territory.

<u>Decision</u> 90-06-025 as quoted in <u>Decision</u> 93-04-058 at 3. The CPUC later concluded in <u>Decision</u> 94-08-022 (Appendix N to California's Petition) that capacity constraints do not exist in any California market, yet basic rates and, particularly wholesale rates have not decreased speedily enough to fill excess capacity.

The CPUC's concern was particularly acute because the CPUC had issued <u>Decision</u> 94-04-043 in April 1994 to eliminate any limitations on rate reductions, provisional and temporary rates allowing such tariff rate filings to take effect upon filing (as long as the existing wholesale margin was preserved).[14] This latter Decision (annexed hereto as Attachment 11) encouraged permanent discounted rates. In addition, the Decision provided specific customer protection guidelines for long-term contracts that (a) guaranteed customers the right to a written contract for any rate package in which the contract would automatically be renewed and (b) required that high termination penalties ($100 to $300) be prorated over the life of the contract.[15]

Although the carriers' comments in the instant proceeding proclaim their readiness to reduce rates in light of the most recent CPUC rate flexibility, in comparison to the 1990 regulatory regime, the record indicates otherwise. For example, between 1990 (when carriers were given the right to immediately decrease rates on a temporary basis) and 1991, LA Cellular filed 20 temporary tariff filings and six (6) temporary promotional filings. When the CPUC further loosened the restrictions in 1993 and 1994, LA Cellular filed only six (6) such filings in 1993 and, to date only two (2) in 1994. See Attachment 12, which

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[14]The Decision also eliminated any limit on service rate credit rebates which had been earlier imposed, pending revision of the USOA. See Decision 92-02-076. A number of duopoly carriers, including BACTC and GTE Mobilnet, assail those former limitations on credits as examples of non-productive regulatory intervention by the CPUC. They neglect to advise this Commission, however, that those limitations were adopted in a proceeding (Decision 86-12-023) in response to a BACTC proposal which had the concurrence of all the duopoly carriers (as well as CRA). See Decision 90-06-025, Mimeo at 78-79.

[15]It is ironic that AirTouch, in its opposition to the CPUC's Petition, decries these basic consumer safeguards. AirTouch Comments at 68.

identifies the advice letters.[16] Moreover, LA Cellular claims as to "discounted" rates based on assumed subscriber usage fails to take into account the early termination penalties ranging from $150 to $200.[17] GTE Mobilnet makes similar claims about its rate plans and certain temporary rate reductions which have expired. See, e.g., GTE Mobilnet Advice Letters 239, 251, 262 and 279. Thus, it is the duopoly carriers -- not the CPUC's regulations -- which have frustrated appropriate rate reductions.

5. Enhancement of Cellular Resale Service

CPUC regulations have had the desired result. Independent resellers number as many as 75 according to CPUC records, and they have provided some rate competition to the retail divisions of the facilities-based carriers.[18]

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[16] Attachment 12 also notes that LA Cellular has mischaracterized 47 of its advice letters as promotional or discount plans when in reality they were mere extensions of existing plans. In addition, eight other plans claimed by LA Cellular as temporary rate reductions or promotions actually involved such matters as cell site modifications, ceiling rate filings under rate band guidelines, and activation fee deferrals which not deleted but added to termination fees.

[17] See LA Cellular Comments at page 20. LA Cellular's Service Plans have a termination fee of $150, and its Corporate Association Plan has a $200 penalty for early termination.

[18] As noted in a recent CPUC hearing, there are at least four independent resellers in major California markets with lower retail plans than the duopoly carriers despite gross profit margins for resellers in 1992 averaging no more than 4%. See Testimony of Gary Mclaughlin in I. 88-11-040, Reporters' Transcript at 2493-94 and 2529; Declaration of David Nelson and Steve Muir, annexed hereto as Attachments 13 and 14.

In 1990 the CPUC decided to enhance the resellers' ability to compete:

> While the duopoly is the centerpiece of the cellular market, many related activities or service components are not limited to the duopoly. Resellers offer competitive marketing and billing and collection services, and propose to go further by offering certain facilities-based enhancements to cellular service (by means of the reseller switch proposal, to be the subject of an upcoming hearing).

Decision 90-06-026 Mimeo at 16. In 1992, after the full evidentiary hearing, the CPUC stated that it concurred "with [the Division of Ratepayers Advocates] that the services being sold on a bundled basis by the facilities-based carriers can be unbundled."[19] The CPUC therefore ordered the unbundling of rates for those functions controlled solely by the facilities-based carriers:

> We therefore unbundle into wholesale rate elements only those functions that cannot be provided by competitors, that is, the portion of the network between the mobile unit and the switch, and certainly switching functions. We see no need to unbundle the wholesale rates into rate elements for services that competitors can provide because we want that portion of the network to be market priced (i.e. the existing wholesale and retail rates).

Id. at 39. The CPUC's rehearing decision (Decision 93-05-069) left those requirements unchanged. See Ordering paragraph 3,

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[19] Decision 92-10-026, Mimeo at 56, also stated that "the wholesale service rates being sold by the facilities-based carriers can be unbundled."

which set forth deletions from Decision 92-10-026.[20] Other undisturbed portions of Decision 92-10-026 allowed resellers to purchase NXX codes directly from the LEC administrator as well as to establish direct interconnection with the LEC (instead of as part of bundled per number charges purchased from the cellular carriers). Decision 92-10-026 at 31 and Conclusion of Law 12 at 59. See Decision 93-05-069.

The CPUC's unbundling rationale is in accord with competitive goals shared by this Commission: ". . . any failure to unbundle wholesale rates runs to counter to our Phase I goal of increasing the competitive forces for cellular service and encouraging the most rapid expansion of cellular service and new technology that is reasonably possible." Decision 92-10-026, Mimeo at 34.

In the CPUC's most recent Wireless Inquiry, in Decision 94-08-023, the CPUC observed that duopoly carriers controlled the vast majority of reseller costs and that the duopoly carriers were still earning excessive profits in their wholesale as well as retail operations. To promote wholesale as well as retail competition, the CPUC reaffirmed its findings from Decision 92-10-026 (unchanged by its rehearing in Decision 93-05-069) authorizing resellers (1) to buy unbundled wholesale cellular

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[20]In its Decision 94-08-022 the CPUC accepted the carriers' claims and did not order cost-based unbundling. Instead, the CPUC ordered the unbundling on the basis of market-based rates. Decision 94-08-022, Mimeo at 73. Thus, AirTouch is disingenuous in its claims that the CPUC's unbundling order is "cost based." AirTouch Comments at 21-22.

service, and (2) to interconnect switches to perform functions that do not require an FCC license, including enhanced services as well as billing, collection and customer service.[21] Thus, it was affirmed that resellers were authorized to purchase direct connection to cellular carriers' MTSOs, LEC central offices, peak and off-peak minutes of use and activation separately on an unbundled basis at the current tariffed wholesale rates. Decision 94-08-023, at 80-84.[22]

6. Carrier Procedural Complaints

The carriers' Opposition to California's Petition in the instant matter advance a variety of criticisms concerning the CPUC's alleged errors in Decision 94-08-022 (Appendix N thereto) and the conclusions which the Petition draws from that Decision. None of these claims has any merit.

At the outset, CCAC claims that the CPUC arbitrarily and capriciously adopted a bandwidth threshold of 25% for definitional purposes of dominance, citing Decision 92-08-022 at 22. CCAC's statement is wrong. The CPUC merely suggested the 25% standard as a possible proposal for implementation after

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[21]Enhanced services include limited calling areas, incoming call screening, distinctive call signaling, priority call waiting, cellular extension, cellular private branch exchange, cellular centrex, voice mail enhancements, dual system access, custom directory service, cellular secretary, multi-line hunting, and billing format design. Decision 92-10-026, Mimeo at 29.

[22]Thus, AirTouch's claim that the CPUC's Decision is unclear as to what is unbundled is false.

further consideration. The CPUC did not adopt the 25% test in its Findings of Fact and Conclusions of Law.

CCAC, LA Cellular and McCaw also claim that the CPUC violated its own procedures and PU Code Sections in adopting Decision 94-08-022. These latter claims are equally meritless. First, there is nothing in the new Section 332 that authorizes this Commission to rule on procedural issues of state law. Second, as demonstrated in Attachment 15 annexed hereto, CRA's September 21, 1994 Response to Applications For Rehearing (filed in reply to similar carrier allegations), the Decision 94-08-022 was adopted in accordance with Sections 454 and 1701 of the PU Code and Commission Rule 14.[23] Even if the CPUC's action could

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[23] Section 454(b) provides in pertinent part as follows:

> The Commission may adopt rules it considers reasonable and proper for each class of public utility providing for the nature of the showing required to be made in support of proposed rate changes, the form and manner of the presentation of the showing, with or without a hearing, and the procedure to be followed in the consideration thereof. (Emphasis added.)

Section 1701 of the PU Code states that the CPUC may formally or informally take evidence in an investigation and that no informality in acquiring evidence shall invalidate a CPUC decision. Finally, CPUC Rule 14.2 of Practice and Procedure states that the CPUC can use its rulemaking authority for

> (a) Proceedings to establish rules, regulations and guidelines for a class of public utilities and other regulated entities; ***
>
> (c) Proceedings on rate making for any class of public utilities or other regulated entities.

(continued...)

be construed as a modification of previous decisions such as Decision 90-06-025, the Phase 1 & 2 Cellular Decision, which was adopted by rulemaking and without hearing), the carriers' challenge to the CPUC's actions would be still unjustified. All of the duopoly carriers had taken the precise opposite view when the CPUC rendered Decision 90-06-025 without hearing on a rulemaking basis -- and those procedures and policies were upheld by the California Supreme Court in Cellular Resellers Association, Inc. et al. v. Public Utilities Commission, No. S018364 (Writ of Review denied April 11, 1991). See Attachment 15 hereto at pgs. 2-10.

CCAC, McCaw, and other carriers also claim that the carriers were somehow fundamentally disadvantaged by data requested by the CPUC in the April 11, 1994 ALJ Ruling and kept under seal at their request. CCAC claims that this Commission cannot rely on such nonpublic information.

This claim is false. CCAC and its constituent members demanded that the information requested by the CPUC on April 22, 1994 be held confidential pursuant to CPUC G.O. 66-C. Pursuant to a May 5, 1994 ALJ ruling, the CPUC established a process for such G.O. 66-C claims and the right of "any party" to view such material pursuant to nondisclosure agreements. See May 5, 1994 ALJ Ruling at paras. 3 & 5. All of CCAC's members and their

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[23/] (...continued)
(d) Proceedings which may modify prior Commission decisions which were adopted by rulemaking. (Emphasis added.)

affiliates providing such data requested confidentiality; neither CCAC or the individual carriers requested the opportunity to review the data. See July 19, 1994 ALJ Ruling.

In contrast, CRA requested and was granted access to the data. Thus, after the deciding not to seek such data and then intentionally avoiding further comment on it, CCAC and its constituent members make a mockery of this Commission's processes with their arguments that the data was not available for review in the CPUC proceeding, when in fact it was to any party willing to enter into a nondisclosure agreement.[24]

The CCAC and carriers' ploy should be juxtaposed with CCAC's current demand that this Commission rely on the same CCAC secret study utilized in the California proceeding, without providing public access to the underlying data in this proceeding. CCAC Comments at 65-68. That secret study purports to show that, since 1990, there has been a decrease in retail cellular rates for large markets for "optimal" plans for high, medium and low volume customers. In I.94-12-007 which resulted in Decision 94-07-022, CCAC insisted that the CPUC rely on the study and at least provided the underlying data of the study pursuant to nondisclosure agreements as required by the CPUC. Here, it has done no such thing, not even providing this Commission the

[24] The only data utilized in the CPUC's petition which was not utilized and available to all parties was that information furnished by the California Attorney General's Office to the CPUC.

underlying data, a tactic also employed by AirTouch and CTIA with their "studies" prepared by Dr. Jerry Hausman.[25]

CCAC's secret study cannot provide any basis for this Commission to deny California's Petition. This is specially so since the data used by CCAC is not based on any subscriber specific data for any member carrier. Rather, as CCAC's appendix A to its "study" states:

> Effective cost per minute rates for each rate plan were calculated at various usage volumes for each market using monthly access rates, minutes included in access, peak and off-peak rates, 80/20 peak and off-peak split and discounts for certain levels of usage. Activation charges were excluded. From the calculations a single optimal plan per market was determined. These optimal plans were segregated by market size and averaged on a straight line basis. Multi-line rate plans were excluded from the analysis. The calculated rates were then adjusted for inflation using a California specific Consumer Price Index for all urban consumers.

In other words, the effective costs per minute for the developed rates exclude activation charges and are nothing more than a composite "optimal rate plans." Hence, the referenced plans are not real rate plans, but averages derived from existing rates. In no way, then, does CCAC's "study" provide data of actual subscriber usage of existing rate plans on an MSA by MSA basis.

[25] Despite the fact that CRA repeatedly requested the underlying data for the Hausman conclusory analyses, neither AirTouch nor CTIA provided the data either publicly or under nondisclosure agreements. See Attachments to King Statement.

III. Carrier Complaints Unfounded

The FCC-licensed cellular carriers obviously want to have this Commission preempt any further CPUC regulation of their respective operations in California. The carriers recognize that CPUC regulation has fostered competition from independent resellers. E.g. CCAC Response at 83 (CPUC regulations "reflect the CPUC's long standing infatuation with the notion that resellers can provide retail competition"). The carriers would much prefer to be able to set rates for service and offer package plans with bundled CPE without facing any independent governmental scrutiny as to whether the prices or bundling practices are discriminatory, unduly high, or otherwise unfair. And they would like to do so without the threat of competition from resellers.

Unfortunately for the cellular carriers, the framework for analysis set forth in Section 332 of the Act poses an insurmountable obstacle to their desires: on the one hand, to succeed the carriers must demonstrate that there is sufficient competition in the California marketplace to generate reasonable and non-discriminatory rates; on the other hand, the carriers must show that such competition -- which would have arisen in a marketplace regulated by CPUC since its inception -- is not in any way a function of the success of CPUC regulation.

The carriers of course try to have it both ways. They claim that there is vigorous competition between the two FCC-licensed cellular carriers, that the carriers have made substantial investments and are prepared to make further investments to improve quality and lower rates, and that their current rates are reasonable and non-discriminatory.

The carriers spare no words of praise for themselves in describing the competition among themselves and the benefits which that competition has provided to the public. Thus, CCAC explains that the "extraordinary" growth of cellular subscribership in California was made possible "by massive infrastructure investment" and provides "the most basic evidence of customer satisfaction with cellular carriers' rates and service." CCAC Response at 63-64. For its part, McCaw claims that "California cellular carriers have established a remarkable record of aggressive investment in system infrastructure and rapid customer growth" in order to expand capacity and lower rates. McCaw Opposition at 31. AirTouch asserts that the California cellular markets "have exhibited all the indicia of intense competition in a concentrated market" and "that cellular rates in California have declined over time as the CPUC granted limited pricing flexibility" -- indeed AirTouch believes that the cellular marketplace in California is so "favorable" as to attract "the first new facility-based cellular competitors," including Nextel Communications, Inc. AirTouch Opposition at 25, 29, 45 (footnote omitted). And GTE Service Corporation ("GTE") adds that "GTE have [sic] constructed and expanded their [sic] cellular systems at a record pace" and that "real rates for cellular service [in California] have fallen dramatically over the past licensed term." GTE Comment at vii, 29 (footnote omitted).[26] GTE complains that the CPUC's mandatory wholesale margin requirement gives independent resellers a "protective shield" which resellers have "consistently failed to utilize . . . to offer customers either unique service packages or reduced rates of service." GTE Comment at 17-18. And some of the carriers -- supported by their economic experts -- contend that the carriers would have no incentive to exploit any market power to limit, if not destroy, the ability of resellers to compete. See Owen Declaration, supra, at 37-38.

Despite the many benefits they have provided to California subscribers under CPUC's regulatory regime, the carriers claim that CPUC regulation over the last ten (10) years is not responsible in any way for the benefits cited by the carriers and that further regulation is not necessary to protect consumers. Review of the carriers' specific complaints, however, compels a completely different conclusion.

### A. Wholesale/Retail Margins and Bundling Not at Issue

The carriers devote extensive argument in criticizing the CPUC's requirement that the facilities-based carriers make service available to resellers at wholesale rates and that any

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[26] The euphoria extolled by the carriers with respect to the scope of their respective investments and the decrease in their rates is clearly at odds with the "doom and gloom" assessment offered by their economic experts. The experts contend that the CPUC regulatory regime has inhibited and will continue to inhibit investment by cellular carriers. E.g. Declaration of Bruce Owen, attached to McCaw Opposition.

rate decreases maintain the margin between wholesale and retail rates. Thus, CCAC asserts that the "CPUC's maintenance of a mandatory margin requirement provides resellers with an easy justification for protesting carriers' rate proposals" and that the margin requirement, along with other CPUC regulations, "directly inhibit additional rate reductions for cellular subscribers. . . ." CCAC Response at 85. McCaw similarly complains that the CPUC's mandate for wholesale rates has "no origin in marketplace forces" and that the CPUC's regulatory program has been flawed "with detailed attempts to assure that resellers obtain 'adequate' margins between wholesale and retail prices. . . ." McCaw Opposition at 20.

The underlying -- and erroneous -- premise of the carriers' arguments is that the CPUC's mandatory wholesale/retail margin regulations are subject to review by the Commission. That premise is not supported by Section 332's language or its legislative history.

Section 332(c)(3)(A) expressly states that the preemption of a State's "authority to regulate the entry of or the rates charged by any commercial mobile service or any private mobile service . . . shall not prohibit a State from regulating the other terms and conditions of commercial mobile services." 47 U.S.C. § 332(c)(3)(A). The CPUC's mandatory wholesale/retail margin concerns the terms under which service is offered by the cellular carriers and does not constitute the kind of rate regulation preempted by Section 332. Thus, the carriers' attempt to bring the CPUC's wholesale/retail margin regulations before this Commission is contrary to the plain and unambiguous language of Section 332. Board of Governors of the Federal Reserve v. Dimension Financial Corp., 474 U.S. 361, 368 (1986) (agency must abide by the clear and unambiguous language of statute).

Moreover, to the extent there was any doubt about Congress' intent, it was certainly removed by the legislative history.

Section 332 originated in the Licensing Improvement Act of 1993, which was offered by Representative Edward J. Markey, Chairman of the House Subcommittee on Telecommunications and Finance. In proposing a "regulatory parity" amendment at the Subcommittee's mark-up session of May 6, 1993, Mr. Markey explained that the proposed preemption of State entry and rate regulation would not apply to any State regulatory requirement concerning a mandatory wholesale/retail margin: "the intent here is not to disturb the principle that carriers can be obligated to offer services to resellers at wholesale prices. For the vast majority of States, their ability to regulate in this area would be preserved." Statement of Representative Edward J. Markey, Mark-Up of Budget Reconciliation, Subtitle C, Licensing Improvement Act of 1993, annexed hereto as Attachment 16.

Senator Daniel Inouye (D-HI), Chairman of the Senate Commerce Committee's Subcommittee on Communications and the principal sponsor of companion Senate legislation (S.335), echoed Mr. Markey's assessment that preemption of State entry and rate regulation would not affect a State's ability to mandate wholesale/retail margins in the sale of cellular service. As Senator Inouye explained at the Senate Commerce Committee's mark-up session on May 25, 1993, "States may continue to regulate the terms and conditions under which mobile service companies operate. This allows States to regulate the customer billing information and practices and billing disputes on other consumer protection matters, like zoning and transfers of control. The carriers [may] make capacity available on a wholesale basis or such other matters that fall within a State's lawful authority. States are only preempted from regulating the rates charged by mobile service companies. . . ."[27/] Commerce Committee, U.S. Senate (May 25, 1993) (unpublished transcript) at 17.

The carriers also complain that CPUC regulation has limited the carriers' ability to bundle service and CPE packages for consumers. Thus, CCAC complains that CPUC "stands alone" in prohibiting bundling of CPE and service. CCAC Response at 83. CCAC also laments the CPUC's decision to require the cellular carriers to unbundle the rate elements for their service and to allow resellers to interconnect their own switches at market based rates. According to CCAC, "[T]he CPUC's unbundling requirement for cellular carriers interferes with federal regulation of CMRS providers and is therefore preempted." CCAC Response at 104. The individual cellular carriers advance

[27/]As of May 25, 1993, Senator Inouye's "regulatory parity" proposal would provide for State preemption if there were three (3) or more CMRS providers in a market. Although that standard was later changed in the final version of Section 332, the intent concerning State preemption remained unchanged.

similar arguments. E.g. McCaw Opposition at 48-49; AirTouch Opposition at 66-68.

The carriers are wrong in believing that this Commission has authority under Section 332 to preempt the CPUC's regulations (1) limiting the carriers' ability to bundle service and CPE, and (2) requiring the carriers to unbundle their service rates and to allow resellers to interconnect their switches with the carriers' MTSOs. As in the case of the mandatory/retail wholesale margin regulations, the bundling and unbundling regulations concern "other terms and conditions" and are not subject to Commission review under Section 332. As Mr. Markey explained in the May 6, 1993 mark-up session of the House Subcommittee on Telecommunications and Finance, the legislation "makes explicit that nothing precludes a State from imposing regulations on terms and conditions of service, which includes [sic] such key issues as bundling of equipment and service and other consumer protection activities." See Attachment 16, annexed hereto.

Even if the mandatory wholesale/retail margins, bundling, and interconnection issues were properly before the Commission, consideration of those matters would not justify a denial of California's Petition. Two salient points underscore the reasonable basis of CPUC regulation on those latter matters.

First, despite their blind recitation of the imminent competition to be proffered by PCS, Nextel, and other CMRS providers, the plain and simple fact is that resellers are currently the only meaningful competition to the two FCC-licensed cellular carriers, and resellers are likely to remain the only meaningful competition for at least the next two to three years (if not later). The Commission itself acknowledged that PCS and ESMR "will not be a reality for some time." Second Report and Order, 9 FCC Rcd at 1470.

The undisputed facts support the Commission's assessment. Broadband PCS licenses will not be issued until the late winter or spring of 1995, and the FCC's rules only require that one-third of the population be covered within the first five (5) years of the license term. Nextel -- the only ESMR provider whose service is perpetually referenced by the carriers' oppositions -- is not currently offering any meaningful service, and Nextel's comments in the instant proceeding merely state that Nextel hopes to be able to offer service in the 50 largest markets by the end of 1996.[28] Comments of Nextel Communications, Inc. at 4. See King Declaration, Attachment 2; Nelson Declaration, Attachment 13.

Second -- and more importantly -- the carriers have the incentive and, absent CPUC regulation, the opportunity to minimize if not completely eliminate any competition offered by independent resellers. As explained in the attached declarations of David Nelson and Steve Muir, the CPUC's mandatory

[28] Congress itself recognized that Nextel would not likely be able to offer meaningful service in the immediate future: the Omnibus Budget Reconciliation Act of 1993 expressly provided that private land mobile service providers, like Nextel, would not be subject to the same common carrier regulations as other CMRS providers until August of 1996. Omnibus Budget Reconciliation Act of 1993, P.L. No. 103-66, Title VI, § 6002(c)(2)(B).

wholesale/retail margin is nothing more than an effort to ensure that the FCC-licensed cellular carriers are not paid monies for costs they do not incur. As a general proposition, cellular rates need to enable the cellular carriers to earn a reasonable return on money spent for customer acquisition, capital investment, general and administrative ("G&A") costs, billing and collections, and bad debt. The cellular carrier does not incur all of those same expenses for the resellers' subscribers. Instead, as explained in the Nelson and Muir declarations, the reseller pays for those same customer acquisition, billing and collection, G&A, and bad debt expenses that might otherwise be absorbed by the cellular carrier.

As Nelson and Muir further explain, cellular resellers in California do not have any objection to rate decreases by the carriers as long as the wholesale margin is maintained. Otherwise, the cellular carrier could use its market position to undersell retail prices to subscribers which would then be cross-subsidized by wholesale rates charged to the independent resellers. The CPUC has recognized that prospect -- which, as explained above, as well as in the Muir and Nelson declarations, can materialize. The CPUC's proscriptions against bundling are designed to make sure that such bundling packages do not provide the carriers with a vehicle to evade the wholesale margin requirements.

The resellers' and CPUC's concerns are reinforced by available data concerning the financial performance of the carriers' respective wholesale and retail divisions. The data show that virtually all of the carriers' wholesale operations are incredibly profitable while many of their retail operations operate at a loss or with sharply reduced profits by comparison. See King Declaration, Attachment 2. The vast differences in financial performance confirm that the carriers are using wholesale rates to recover virtually all of their costs, leaving them free to cut retail rates below those of any competitor. Despite that financial cushion, the resellers have -- contrary to the carriers' arguments -- offered a variety of innovative pricing plans which usually include prices below those of the FCC-licensed cellular carriers. See Nelson and Muir Declarations, Attachments 13 and 14. In short, the resellers are attempting to provide the very kind of competitive spur which the CPUC envisioned through its various regulations.

Similarly, the CPUC's authorization of interconnection of reseller switches is nothing more than an effort to enable resellers to spend millions of dollars for their own switches in an effort to improve service and lower prices to the end users. The issues surrounding reseller interconnection to the carriers' MTSOs are being pursued in other FCC proceedings and need not be explored at length in the instant matter. It is sufficient to note for present purposes that, regardless of how the Commission may ultimately decide any interconnection issues in the future, the present record amply demonstrates that California has a reasonable basis for proceeding as it has on those issues.[29]

B. Carriers' Excessive Returns Warrant Regulation

The FCC-licensed cellular carriers' excessive earnings constitute a major focus of the Petition's basis for continued State regulation of the next eighteen (18) months. The Petition observed, for example, that the Los Angeles Cellular Telephone Company -- which serves the largest MSA -- had "an average annual after-tax accounting rate of return of 56.2 percent for the last five years," that the other carrier in Los Angeles (Los Angeles SMSA) "earned 37.9 percent annually on average over the same period," that the BACTC in the San Francisco MSA "had earnings that ranged from 31.1 percent in 1992 to 49.5 percent in 1993, with an annual average of 43.2 percent for the five years," and that AirTouch in San Diego "earned an average of 28.3 percent per year for the last five years" -- all of which "occurred during the worst recession in recent California history." Petition at 48-49 (emphasis added).

None of the carriers disputes the statistics proffered by the Petition. Instead, they try to argue that the returns are not as high as they appear to be. To accomplish that "trick,"

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[29] CSI and ComTech have filed a petition for reconsideration of the Second Report and Order, supra, to the extent it does not clearly recognize the resellers' right to interconnect with the cellular carriers. CSI and ComTech, along with CRA, have also filed comments in the Commission's notice of inquiry on CMRS interconnection issues. Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Services, CC Docket No. 94-54.

the carriers proffer the opinion of various experts who contend that "accounting rates of return" are inappropriate for evaluating the carriers' financial performance and that a more appropriate standard would be the so-called "economic rates of return." E.g. CCAC Response at 40-44; McCaw Opposition at 43-46; AirTouch Opposition at 54-56, 59. Stripped of all its expert verbiage, the essence of the carriers' contention is quite simple: they believe "accounting rates of return" are inadequate because such returns reflect the profits on investments actually made, while the so-called "economic rates of return" enable the carriers to earn money on the replacement or reproduction value of their entire system -- which include the value of the spectrum for which they paid nothing.[30/]

No amount of expert rhetoric can disguise the true impact of the carriers' proposal: they would like to earn money on investments they have not made. The carriers' invocation of "economic rates of return" is merely another way of asking this Commission to preempt State regulation which prohibits the carriers from preserving the "fair value" of their assets based on current market levels.

This Commission, like other regulatory agencies, have -- for decades -- rejected use of that "fair value" theory on the grounds that investors are only entitled to a fair return on

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[30/]To the extent any carrier acquired its FCC license in the secondary market, that investment would, as explained in the declaration of Charles L. King, be reflected in the accounting rates of return.

their investment and not a return on the reproduction or replacement value of the company's assets. Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 605-14 (1944) (FPC acted reasonably in authorizing a return on actual investment rather than on the "so-called 'fair value' rate base"); 1990 Rate Represubscription, 5 FCC Rcd 7507, 7521 (1990) (common carriers not entitled to a return on the "fair value" of their investment on the basis of the company's market value); Association of American Railroads v. Interstate Commerce Commission, 978 F.2d 737, 741 (D.C. Cir. 1992) (ICC acted reasonably in concluding that rates of return should be calculated on the actual cost of equipment obtained from another railroad rather than the original (and presumably higher) cost to the original purchaser). As one court observed, "The Supreme Court has made clear that the FCC has no obligation to maintain the current market value of investors' property." Illinois Bell Telephone Company v. FCC, 988 F.2d 1254, 1262 (D.C. Cir. 1993).

In requesting the Commission's denial of California's Petition, the carriers are asking for just that kind of protection. Their investors have become accustomed to extraordinary profits on their actual investments, and the carriers understandably would like to honor and even perpetuate those expectations. While the carriers' motivation may be understandable from a self-interested business perspective, it cannot provide the basis for regulation premised on the public interest. If reproduction costs or fair value were a determinant of rates, parties like the carriers -- who have been given a license to use scarce spectrum for free -- would invariably be in a position to charge exorbitant rates to consumers. For that reason, the Commission has used rate of return on actual investment as a bedrock for ratemaking decisions. See Virgin Islands Telephone Corp. v. FCC, 989 F.2d 1231, 1233-34 (D.C. Cir. 1993) and sources cited therein.

The carriers' desire to earn excessively high accounting rates of return is particularly inappropriate since such returns are not needed to discourage excessive consumer use of limited transmission capacity. There is, in fact, a certain irony in the arguments of CCAC and each of the carriers in response to the Petition's claim that the carriers have excess unused capacity and that the carriers are not pricing their service at sufficiently low rates to fully utilize existing capacity. CCAC and each of the carriers vigorously dispute any notion that they are artificially maintaining excess capacity in order to keep prices high and achieve high rates of return. CCAC and the carriers maintain that there is no need to maintain artificially high prices to constrain demand because cellular carriers are making substantial investments and expanding capacity as quickly as possible. E.g. McCaw Opposition at 41-43. As AirTouch states, "[T]he carriers have invested heavily in research and development of cellular technology" to expand capacity. AirTouch Opposition at 53. LA Cellular Telephone Company similarly states that there is no merit to "the CPUC's extraordinary theory that carriers have deliberately suppressed expansion efforts in order to keep prices and profits abnormally high." Response by Los Angeles Cellular Telephone Company at 32.

This Commission, then, is left with two undisputed facts: first, there is ample capacity to handle whatever consumer demand might arise from lower prices; but, notwithstanding that additional capacity, the carriers and their investors have been able to consistently earn returns that far exceed what any prudent investor might expect from a competitive market. If the cellular markets in California were in truth characterized by intense competition and ease of entry, there would surely be additional competitors flocking to provide cellular service and share the extraordinary profits reaped by the carriers.

The foregoing analysis is supported by Charles W. King, an independent economic expert retained by CRS, CSI and ComTech. In his declaration, annexed hereto as Attachment 2, Mr. King explains why the economic rates of return urged by the carriers cannot be squared with the public interest or any conclusion that the cellular market is indeed competitive. As a telling example, he cites the soft drink industry, where two major competitors are forced to maintain lower prices for fear that higher prices -- and abnormally high profits -- will attract "swarms of competitors." King Declaration at 27.

As Mr. King also points out, the carriers cannot fault the CPUC for rates which the carriers now believe should be lower. There is nothing in CPUC's regulations which precludes any